

## Message Text

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C O N F I D E N T I A L MADRID 6788

E.O. 11652: GDS

TAGS: EFIN, EGEN, SP

SUBJECT: BANK OF SPAIN OFFICIALS DISCUSS ECONOMIC SITUATION

1. SENIOR BANK OF SPAIN OFFICIALS HAVE TOLD CHARGE AND ANOTHER EMBASSY OFFICER THAT SUBSTANTIAL DECLINE IN EXPECTED GOVERNMENT DEFICIT FOR 1976 AS RESULT RECENT GOS ACTIONS WOULD NOW PERMIT GREATER MONETARY FLEXIBILITY AND ENABLE BANK OF SPAIN TO INCREASE CREDIT TO PRIVATE SECTOR, EASING PRESENT SQUEEZE SOMEWHAT. WITH COMMERCIAL BANKS IN VERY TIGHT POSITION AND MANY COMPANIES, PARTICULARLY SMALL TO MEDIUM SIZED, IN PRECARIOUS FINANCIAL CONDITION, THIS IS A WELCOME DEVELOPMENT FOR PRIVATE SECTOR, AS WELL AS HOPEFUL INDICATION REGARDING OVERALL GOS ECONOMIC POLICIES ALTHOUGH FINAL RETURNS NOT YET IN ON OVERALL ECONOMIC POLICY FOR THIS YEAR AND FUTURE REMAINS DIFFICULT.

2. TOTAL GOS DEFICIT HAD BEEN EXPECTED TO REACH AS HIGH AS 185 BILLION PESEGAS IN 1976 BUT ACCORDING TO RECENT ESTIMATES BY MINFIN AND BANK OF SPAIN FIGURE NOW EXPECTED TO BE ABOUT 120 BILLION, AS RESULT BOTH HIGHER GOVERNMENT RECEIPTS AND LOWER OUTLAYS DERIVING FROM RECENT GOS ACTIONS. THIS 120 BILLION WILL BE LARGELY OFFSET MONETARILY BY BALANCE OF PAYMENTS DEFICIT AND INCREASED CASH HOLDINGS. AS A RESULT BANK OF

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SPAIN IS NOW IN A POSITION TO INCREASE CREDIT AVAILABLE TO PRIVATE

SECTOR SOMEWHAT WHILE STILL MAINTAINING 20 PERCENT TARGET FOR GROWTH OF MONEY SUPPLY THIS YEAR.

3. BANK OFFICIALS SAID THEY HAD POINTED OUT TO GOVERNMENT THAT MONETARY EXPANSION AND THUS INFLATION COULD NOT BE CONTROLLED UNLESS ACTION TAKEN TO REDUCE DEFICIT THAT WOULD HAVE OCCURRED HAD NOT RECENT TAX INCREASES AND BUDGET CUTS BEEN UNDERTAKEN. APPARENTLY THEIR POINT HAD BEEN UNDERSTOOD, AND THEY WERE MIDLY ENCOURAGED THAT THE PRESENT GOVERNMENT SEEMED TO BE PAYING MORE ATTENTION TO THE FISCAL PROBLEM THAN DID THE PREVIOUS ONE.

4. THEY SAID NEW HEAD OF THE BANK OF SPAIN LOPEZ DE LETONA IMPRESSED AS A QUICK LEARNER AND DETAILIST. THEY PRESUMED FROM HIS INDUSTRIALIST BACKGROUND THAT HE WOULD BE BIASED TOWARD EASY CREDIT, BUT THEIR PAST EXPERIENCE WAS THAT THE POSITION TENDED TO FORM THE MAN, AND THEY THUS EXPECTED HIM TO FOLLOW RESPONSIBLE POLICIES FROM THE BANK OF SPAIN POINT OF VIEW.

5. IN OTHER COMMENTS ON 1976 SPANISH ECONOMIC PERFORMANCE, BANK OF SPAIN DIRECTOR GENERAL FOR DOMESTIC AFFAIRS ANGEL MADRONERO AND DIRECTOR GENERAL OF (ECONOMIC) STUDIES ANGEL ROJO SAW REAL INFLATION FOR 1976 OF 18 PERCENT, ALTHOUGH OFFICIAL FIGURE WOULD PROBABLY SHOW 20 PERCENT DUE TO DISTORTION FROM BREAD PRICES; PREDICTED REAL GROWTH IN GNP IN EXCESS OF 3 PERCENT; SAID THAT REAL UNEMPLOYMENT WAS PROBABLY MUCH LESS THAN THE 800,000 ESTIMATED BY THE STATISTICAL INSTITUTE, ALTHOUGH THIS IS THE GENERALLY ACCEPTED FIGURE; SAW VIRTUALLY NO CHANCE FOR MUCH IMPROVEMENT IN BALANCE OF PAYMENTS DEFICIT WHICH THEY SAID WILL CONTINUE TO EXCEED \$3 BILLION.

6. ROJO AND MADRONERO STRESSED THE CLOSE INTERRELATION BETWEEN CURRENT POLITICAL AND ECONOMIC SITUATIONS. A MAJOR STABILIZATION EFFORT WAS NOT POSSIBLE IN THE CURRENT SITUATION. A MAJOR REACTIVATION EFFORT WOULD NOT BE SUCCESSFUL AND WOULD EXACERBATE THE INFLATION AND BALANCE OF PAYMENTS PROBLEMS. THUS AN INTERMEDIATE COURSE WAS THE ONLY PRACTICAL ONE; THE QUESTION WAS IN WHAT DIRECTION THAT INTERMEDIATE COURSE WOULD LEAN. ECONOMIC POLICY FOR REMAINDER OF YEAR HAD YET TO BE DECIDED. THE ECONOMIC MEASURES TAKEN SO FAR BY SUAREZ GOVERNMENT WOULD PROBABLY HAVE A NEUTRAL OVERALL EFFECT ON UNEMPLOYMENT, INFLATION, AND

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ECONOMIC GROWTH. THE GOVERNMENT WOULD BE SORELY TEMPTED TO LEAN SOMEWHAT TOWARD EXPANSION DURING THE REST OF THE YEAR. ON THE OTHER HAND, ITS MOST RECENT FISCAL ACTIONS HAD BEEN ENCOURAGING.

7. LOOKING TO THE FUTURE, MADRONERO AND ROJO SAW INFLATION AS THE CENTRAL PROBLEM AND THE KEY TO ITS CONTROL FISCAL AND WAGE RESTRAINT. IN THE LATTER RESPECT, ROJO THEORIZED THAT SINCE THE COMMUNISTS CONTROLLED A LARGE SECTOR OF LABOR THROUGH THE

WORKERS COMMISSIONS BUT WERE NOT REALLY VERY STRONG POLITICALLY THE GOVERNMENT WOULD DO WELL TO TRADE OFF LEGALIZATION OF THE COMMUNIST PARTY FOR A COMMUNIST COMMITMENT TO WAGE RESTRAINT.

8. WITH REGARD TO THE STRUCTURAL BALANCE OF PAYMENTS PROBLEM, THEY ARE SOMEWHAT OPTIMISTIC ABOUT FUTURE PETROLEUM PRODUCTION POSSIBILITIES, AND SEE ADEPTATION OF AGRICULTURAL PRODUCTION TO SPAIN'S BALANCE OF PAYMENTS NEEDS AND EXPORT PROMOTION THROUGH MEANS INCLUDING LONG TERM DEPRECIATION OF THE PESETA AS LOGICAL REMEDIAL ACTIONS.

9. COMMENT: MADRONERO AND ROJO ARE TWO OF THE MOST RESPECTED MEMBERS OF SPANISH FINANCIAL/ECONOMIC COMMUNITY, AND THEIR VIEWS ARE ALWAYS WORTH LISTENING TO. WHILE NOTING THAT SOME ASPECTS OF ECONOMIC PICTURE ARE PERHAPS NOW BETTER THAN MANY FEEL, THEY ARE BY NO MEANS OPTIMISTIC ABOUT THE CURRENT SITUATION NOR THE OUTLOOK FOR THE MEDIUM TERM. EVEN IF THEIR ESTIMATE OF AT LEAST 3 PERCENT REAL GROWTH FOR 1976 IS CORRECT, AND THIS STRIKES US AND MANY OTHERS AS RIGHT, THE RATE OF INFLATION, WHICH THEY VIEW AS THE MOST SERIOUS PROBLEM AT THIS TIME, REMAINS EXCESSIVE, AND THE BALANCE OF PAYMENTS SITUATION SHOWS NO SIGNS OF IMPROVEMENT. THEY ARE GENUINELY CONCERNED BY THESE TWO FACTORS, AND WE BELIEVE THEY SHOULD INDEED BE SO. END COMMENT.  
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